GLOBAL SMALL BUSINESS AND MICROENTERPRISE CREDIT PROGRAM II

(AR-0127)

EXECUTIVE SUMMARY

Borrower:	The Argentine Republic
Executing agencies:	The Secretariat for Small and Medium-sized Business, Office of the President of the Republic (SEPyME). The Central Bank of Argentina (BCRA) will act as financial agent.
Amount and source:	1. Ordinary capital (foreign exchange) – credit component

IDB:	US$ 98,000,000 (OC/for ex)
Local counterpart funding:	US$ 98,000,000
Total:	US$196,000,000

The IDB funding will be in US dollars from the Single Currency facility.

2. Ordinary capital (local currency) – technical assistance component

IDB:	US$2,000,000 (OC/lc)
Local counterpart funding:	US$2,000,000
Total:	US$4,000,000

Terms and conditions:

1. Ordinary capital (foreign exchange)

Amortization period:	20 years
Commitment period:	3 years
Disbursement period:	4 years
Interest rate:	Variable
Inspection and supervision:	1%
Credit fee:	0.75%

2. Ordinary capital (local currency)

Amortization period:	20 years
Commitment period:	3 years and 6 months
Disbursement period:	4 years
Interest rate:	4%
Inspection and supervision:	1%
Credit fee:	N/A

Objectives: The principal objective of the program is to continue providing credit support to enhance the productive capacity of small businesses and microenterprises (SBMs), and thereby help them to become more competitive and to reduce unemployment.

A supplementary objective of this operation, which draws upon the lessons learned from execution of the first SBM Program (Loan Contracts 643/OC-AR and 867/SF-AR), is to serve as a catalyst in encouraging participating intermediary financial institutions (IFIs) to respond more fully to SBM credit demands, on a self-sustaining basis from their own resources.

Description: The proposed program consists of two components: (i) a credit component (US$196,000,000), to be channeled through regulated IFIs that meet the eligibility criteria of the program and are willing to provide financing at market terms and conditions and to make increasing use of their own resources in support of the target group; and (ii) technical assistance (US$4,000,000), which will include activities to promote the transfer of appropriate lending technology to eligible IFIs and to provide institutional strengthening for the executing agency.

Environmental and social impact review: The Committee on Environment and Social Impact reviewed and approved the program. Its recommendations focus on continuing and strengthening the activities launched under the first program using Bank guidelines for this type of operation. These recommendations have been incorporated into the Loan Proposal (see paragraphs 2.22 to 2.27 and 3.44 to 3.47) and the Credit Regulations.

Benefits: 1. Benefits to small business and microenterprise:

The planned program is intended to support an expanded supply of credit to SBMs, on market terms and conditions, so that they can take advantage of investment opportunities that were hitherto beyond their reach. As well, it will serve to foster greater competition in the supply of such financing, to the benefit of borrowers.

The program will encourage commercial banks to pay more attention to the SBM sector by demonstrating that this is a segment that offers real possibilities for developing a permanent financing relationship. Achieving this objective will mean incorporating this type of financing as part of the commercial banks' business strategy so that in the future they will devote increasing amounts of their own resources to such lending, rather than relying solely on funding from international agencies. Having permanent access to credit will make these productive units more viable and help to increase their revenues.

2. Benefits for the IFIs

Bringing new SBMs into the bank lending market will mean a more diversified client base for financial institutions and hence a better distribution of risk. As well, it may be expected that over time SBMs will require other kinds of banking services, offering new business opportunities for the IFIs. The program will also make it possible to attract institutions that have traditionally shied away from lending to SBMs, thus making the market more competitive.

On the other hand, the program will foster rapid growth in IFI loan portfolios and will help them to improve their lending methodology and to achieve economies of scale. This will allow participating institutions to become more efficient in working with SBMs.

Risks:

1. Macroeconomic context

Social pressures arising from a deterioration in macroeconomic conditions could lead the government to change the course of its economic policy to the detriment of the current environment of price stability. The impact of such a shift on investment, credit demand and the willingness of the IFIs to provide credit is unpredictable. Nevertheless, the measures undertaken by the government (for example, fiscal control) suggest that the country will maintain its present course despite an unfavorable international economic setting.

2. IFI solvency

Experience during execution of SBM I showed the need to ensure that IFIs participating in the program are financially sound and in compliance with the demanding regulatory requirements of the BCRA, in particular with respect to the smaller banks. Strict observance of the program's eligibility criteria will ensure that all participating entities are solvent and capable of operating competitively.

3. The situation of the SBMs

Despite the economic reforms that have been undertaken in Argentina, SBMs still face a number of limitations flowing essentially from the high fixed costs inherent in their lack of economies of scale. In addition, the relatively few support services to which SBMs have access are inadequate, and this fact, combined with market failures (asymmetries of information and externalities), has limited their response to structural reform. In this respect, the government, through the SEPyME , has taken a series of initiatives which, together with this proposed program, will make it easier for SBMs to gain access to financial and nonfinancial services that will improve their competitive positioning. The Bank is supporting several of these initiatives, as mentioned in the project report.

Project role in the Bank's country and sector strategy:

The Bank's activity in Argentina is concentrated in three basic areas: (i) strengthening and consolidating the **modernization of the State** at the central level and extending this to the provincial and municipal governments; (ii) **reducing poverty and raising living standards** through efforts to increase the quality and coverage of social programs; and (iii) **enhancing the productivity and competitiveness** of the commodity-producing sectors of the economy, with a focus on environmental protection, through the provision of support infrastructure, upgrading the productive apparatus and promoting regional integration.

This program will help to enhance the productive capacity and competitiveness of SBMs through the supply of credit, and will seek to institutionalize a financial services mechanism targeted at this sector. In addition, it will contribute to reducing poverty and raising living standards in the SBM sector.

Exceptions to Bank policy:

None.

Special contractual conditions:	**Conditions precedent to the first disbursement**: (i) the borrower and the BCRA will sign an agreement setting out the obligations of each party in executing the program (see paragraph 3.2); (ii) the Director of the PCU and the operational and administrative coordinators will be selected and hired on terms agreed with the Bank (see paragraph 3.5 (a), (b) and (c)); and (iii) the Credit Regulations must be in effect (see paragraph 3.8). **Conditions during the life of the financing**: two special evaluations of the program will be performed during execution, after funds have been committed to the extent of 25% and 75%, respectively (see paragraphs 2.17, 3.50 and 3.56).
Poverty targeting and social sector classification:	This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth General Increase in Resources (document AB-1704). Furthermore, this operation does not qualify as a poverty targeted investment (see paragraph 4.6). The borrower will not be using the 10 percentage points in additional financing.
Procurement of goods and services:	For the procurement of goods and services, where required, the Bank's standard procedures will be used.